

# **REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND COUNCIL ON CHRIS HANI DISTRICT MUNICIPALITY**

## **REPORT ON THE CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the consolidated and separate financial statements of the Chris Hani District Municipality and its subsidiary set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2014, the consolidated and separate statement of financial performance, statement of changes in net assets, and cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the consolidated and separate financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practise (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## Basis for qualified opinion

### Commitments

6. GRAP 17 on *Property, plant and equipment* requires disclosure of contractual commitments for the acquisition of property, plant and equipment. The municipality did not fully comply with this requirement as the manual commitments register prepared was found to have numerous deficiencies, in that commitments were included on the commitments register at the incorrect amounts, and not all commitments of the municipality were identified and included on the register. Consequently, the net overstatement of commitments as disclosed in note 37 to the financial statements is R372,92 million.

### Corresponding figure – Cash flow statement

7. During 2012-13 sufficient supporting documentation was not provided to support the calculations for the amount disclosed for payments to suppliers under cash flows from operating activities. Consequently, I was unable to determine whether any adjustment to the prior year cash flow disclosure was necessary. My audit opinion on the financial statements for the year ended 30 June 2013 was modified accordingly. My opinion on the current year's financial statements is also modified because of the possible effect of this matter on the comparability of the current year's figures.

### Aggregation of immaterial misstatements

8. The financial statements are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements:
9. Making up and as disclosed in the statement of financial position:
  - payables from exchange transactions are understated by R7,73 million
  - property, plant and equipment is overstated by R7,23 million
  - accumulated surplus is overstated by R29,53 million.
10. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm by alternative means, or determine whether adjustments were required to:
  - inventory as per note 10 as disclosed in the statement of financial position
  - property, plant and equipment as per note 3 as disclosed in the statement of financial position
  - payables from exchange transactions as per note 18 as disclosed in the statement of financial position.

### Qualified opinion

11. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Chris Hani District Municipality and its subsidiary as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

### Emphasis of matters

12. I draw attention to the matters below. My opinion is not modified in respect of these matters.

#### **Restatement of corresponding figures**

13. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during the year ended 30 June 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

#### **Unauthorised expenditure**

14. As disclosed in note 44 to the financial statements, unauthorised expenditure amounting to R14,45 million (2013: R238,24 million) was incurred by the municipality during the year. This was the result of the overspending of the total amount appropriated per vote for the Planning and Development, and Technical Services departments in the municipality's approved budget.

#### **Irregular expenditure**

15. As disclosed in note 46 to the financial statements, irregular expenditure amounting to R136,36 million (2013: R300,38 million) was incurred by the municipality during the year ended 30 June 2014. This was as a result of non-compliance with the required procurement processes.

#### **Additional matter**

16. I draw attention to the matter below. My opinion is not modified in respect of this matter:

#### **Unaudited disclosure notes**

17. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

18. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priorities or objectives presented in the annual performance report, compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

#### **Predetermined objectives**

19. I performed procedures to obtain evidence about the usefulness and reliability of Key priority area (KPA) 1: Basic service delivery and Infrastructure development on pages x to x presented in the annual performance report of the municipality for the year ended 30 June 2014:
20. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
21. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities or objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information (FMPPI)*.

22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. The material findings in respect of the selected development priorities or objectives are as follows:

#### **Usefulness of reported performance information**

24. Section 41(c) of the MSA requires that the integrated development plan (IDP) should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 25% of the reported objectives included in the annual performance report were not consistent with the objectives in the approved IDP and the Service delivery and budget implementation plan (SDBIP). This was due to the lack of reviews of the completeness of the annual performance report against the IDP and SDBIP by management.
25. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 79% of the targets in relation to the selected KPA were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management did not correctly apply the principles contained in the FMPPI when setting targets.
26. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 26% of the targets relevant to the selected KPA. This was due to the fact that management did not have sufficient appropriate audit evidence to show how targets were measured.
27. The FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 60% of the indicators relevant to the selected KPA were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the lack of development and implementation of proper performance planning and management practices to facilitate the development of performance indicators for inclusion in the IDP.
28. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 62% of the indicators relevant to the selected KPA were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of standard operating procedures and key controls in the relevant systems of collection, collation, verification and storage of actual performance information.
29. The FMPPI requires that the indicator should relate logically and directly to an aspect of the institution's mandate, the realisation of strategic goals and objectives. A total of 48% of indicators did not relate logically and directly to an aspect of the institution's mandate and realisation of strategic goals and objectives as per the IDP. This was due to management not appropriately defining its indicators to report on the achievement of the service provided.

### **Reliability of reported performance information**

30. The FMPII requires that auditees should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to the selected development priority. This was due to limitations placed on the scope of my work due to the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to the programme. The institution's records did not permit the application of alternative audit procedures.

### **Additional matter**

31. I draw attention to the following matter:

### **Achievement of planned targets**

32. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities or objectives reported in paragraphs 26 to 30 of this report.

### **Compliance with laws and regulations**

33. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA, are as follows:

### **Strategic planning and performance management**

34. The performance management system and related controls were not appropriately maintained as it did not sufficiently describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed, as required by section 38 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and regulation 7 of the *Municipal planning and performance management regulations* (GNR 796 of 24 August 2001) (MPPMR).

35. The municipality did not establish adequate mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

36. Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and regulations 12(1) and 12(2)(e) of the MPPMR.

### **Budget**

37. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

### **Financial statements and annual report**

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements in respect of commitments, cash flow statement, accumulated surplus and property, plant and equipment were not corrected which resulted in the financial statements receiving a qualified audit opinion.

### **Expenditure management**

39. Reasonable steps were not taken to prevent unauthorised and irregular expenditure, as required by section 62(1)(d) of the MFMA.

### **Audit committee**

40. The performance audit committee did not:

- adequately review the municipality's performance management system and make recommendations to the council, as required by regulation 14(4)(a)(ii) of the MPPMR
- adequately review all quarterly internal audit reports on performance measurement, as required by regulations 14(4)(a)(i) and 14(4)(b) of the MPPMR
- submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by regulation 14(4)(a)(iii) of the MPPMR
- meet at least twice during the financial year, as required by regulation 14(3)(a) of the MPPMR.

### **Internal audit**

41. The internal audit unit did not:

- adequately and continuously assess the functionality of the performance management system, as required by regulation 14(1)(b)(i) of the MPPMR
- audit the performance measurements on a continuous basis and submit quarterly reports on their audits to the municipal manager and the performance audit committee, as required by regulation 14(1)(c) of the MPPMR.

### **Human resources management**

42. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury within the prescribed dates as required by regulation 14(2)(a) of the *Municipal Regulations on Minimum Competency Levels* (MRMC) published in GNR 493 dated 15 June 2007.

### **Procurement and contract management**

43. Awards were made to providers who are in the service of the municipality in contravention of section 112(j) of the MFMA and supply chain management (SCM) regulations 44. Furthermore, the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c).

44. Awards were made to providers whose directors are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

45. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2).

46. Quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

47. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.

#### **Conditional grants**

48. The implementation plan in respect of the Local Government Financial Management Grants allocation was not submitted for audit purposes and therefore it could not be substantiated if the grant was spent in accordance with the applicable grant framework, in contravention of section 16(1) of the DoRA.
49. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Systems Improvement Grant allocation, as required by section 12(5) of the DoRA.

#### **Consequence management**

50. Unauthorised, irregular, and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

#### **Internal control**

51. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

#### **Leadership**

52. The leadership tone that promotes accountability was evident, however, it was not embedded in the financial and performance reporting disciplines of the municipality. There was still a lack of oversight to ensure consistent implementation and monitoring of daily, weekly and monthly controls over financial, performance information and compliance with laws and regulations. This was mainly due to the fact that staff members did not fully understand the performance reporting and the leadership's slow response to my recommendations on preparations and review of daily, weekly and monthly financial and performance information. In addition, consequence management was not implemented against officials who were responsible for incurring unauthorised, irregular, and fruitless and wasteful expenditure as investigations were not executed during the year under review.
53. The municipality did not properly plan and provide training on planning, managing and reporting on performance information to meet the requirements of the FMPPI. The lack of adequate performance information reporting prevents the municipality from adequately monitoring the achievement of its objectives. The resultant impact on service delivery is unknown and is dependent on the public's intervention to bridge the gap. Leadership's intervention in this regard is essential.
54. The municipality still have to appoint consultants for the preparation of financial statements due to a shortage of in-house skills and competencies. However, the municipality must adopt a proper strategy to fill vacant positions to ensure that the opportunity exists for the necessary skills transfer from the consultants to the responsible employees. This will ensure that the reliance on consultants is reduced over time.

### **Financial and performance management**

55. The municipality improved its system of records management for the current year, however, the improvement did not have the desired impact, as the municipality did not have a proper system of records management for the financial environment as a whole as material misstatements were identified as well as an aggregation of numerous immaterial misstatements, resulting in a qualified audit opinion. The maintenance of supporting information was deficient for performance reporting. The fair presentation of financial reporting and the reliability of performance reporting are therefore affected. In addition, there is a lack of information relating to the collection, collation, verification, storing and reporting of actual performance information. This was due to the municipality not having standard operating procedures in place to ensure that all documentation is properly maintained for performance management and not preparing complete, accurate and reliable monthly and quarterly financial and performance reports. As a result, the municipality did not identify errors timeously, resulting in material misstatements not being corrected.
56. The municipality did not have systems in place to monitor compliance with all applicable legislation. Non-compliance with laws and regulations could have been prevented had compliance been properly reviewed and monitored. There was a lack of supervision, monitoring and consequence management in respect of the reporting process. As a result, inadequate steps were taken to prevent and detect the incurrence of unauthorised and irregular expenditure, and this promoted the culture of acceptability of non-compliance with laws and regulations
57. The municipality did not have comprehensively documented systems for user access controls and security management controls and, as a result, user activities were not monitored and terminated users were not removed. Therefore, the municipality is vulnerable and at risk of losing data and is susceptible to fraudulent activities.

### **Governance**

58. Although a fully competent internal audit unit and audit committee were in place, the recommendations of the audit committee and internal audit unit were not adequately addressed by management and therefore had a negative impact in addressing control deficiencies that exists in the municipality's control environment and IT systems.
59. The performance audit committee only met once during the financial year and did not adequately review the performance management system.
60. The municipality performed a risk assessment and submitted it to the audit committee during October 2013, while the fraud prevention plan was only reviewed and updated in February 2014, and as a result controls were not timeously designed and implemented to mitigate risks that exist over financial, service delivery and compliance processes for the year under review.

61. The governance processes of the municipality will only be effective when those responsible for the implementation and monitoring of internal controls are held accountable.

Auditor-General

East London

12 December 2014



AUDITOR-GENERAL  
SOUTH AFRICA

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